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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

DOVER MOBILE ESTATES,
Debtor.

Case No. 91-54288-MM
Chapter 11

**MEMORANDUM DECISION AND
ORDER ON MOTION FOR
CLARIFICATION OF
DISGORGEMENT ORDER**

INTRODUCTION

Before the court for consideration is the motion of the Mezzetti Law Firm for Clarification of the Court's Order to Disgorge Fees. Specifically, the motion seeks direction from the court as to the recipient of certain funds subject to court order. At issue is the appropriate disposition of approximately \$55,000 in funds paid as legal fees that this court ordered to be disgorged by counsel in June 1993. Since that time, both the Bankruptcy Appellate Panel and the Court of Appeals for the Ninth Circuit have affirmed this court's order disqualifying counsel and compelling return of fees paid, this court has held the Mezzetti Law Firm ("Mezzetti") in contempt for failure to disgorge the funds, the District Court has adopted substantially the findings of this court upon *de novo* review, and the debtor in possession has dismissed the chapter 11 case upon reaching the terms of a compromise

1 with the secured lender, GAP Portfolio Partners (“GAP”). Upon Mezzetti’s motion for clarification,
2 the court orders Mezzetti to pay the disgorged funds to Dover Mobile Estates. Mezzetti is further
3 ordered to make payments to GAP and to Dover Mobile Estates pursuant to the District Court’s
4 Order on a *pro rata* basis.

5 6 **FACTS**

7 **A. Background**

8 The former debtor, Dover Mobile Estates (“Dover”), is a real estate partnership that owned
9 and operated the Old Town Shopping Center in Los Gatos, California. Jay Shulman and Income
10 Property Investments, Inc. are the general partners of Dover. Dover filed a voluntary chapter 11
11 petition on July 16, 1991 when Great American Bank, which held a deed of trust on the property,
12 sought judicial foreclosure of the property. Dover removed the judicial foreclosure action from the
13 Santa Clara County Superior Court to the Bankruptcy Court post-petition. However, when counsel
14 for Dover became terminally ill, the Mezzetti Law Firm substituted as special counsel for Dover and
15 its general partners in February 1992 absent court appointment. Without prior bankruptcy court
16 authority, Dover paid Mezzetti approximately \$56,000 in post-petition legal fees. GAP acquired
17 Great American Bank’s interest in the property in September 1992.

18 19 **B. Disgorgement Order**

20 When it came to Mezzetti’s attention in January 1993 that it had not been formally appointed
21 to represent Dover, Mezzetti sought authority from the court to be appointed on a *nunc pro tunc*
22 basis. Concurrently with Mezzetti’s motion for *nunc pro tunc* appointment, the court heard GAP’s
23 motion for return to the debtor of post-petition legal fees and expenses paid to Mezzetti. By its
24 Memorandum Opinion issued in June 1993, the court ordered Mezzetti to disgorge attorneys’ fees
25 paid by the debtor from GAP’s cash collateral and declined to appoint Mezzetti as special counsel
26 for the debtor based on a conflict of interest. The court subsequently issued its Order incorporating
27

1 by reference the court's Memorandum Opinion (the "Disgorgement Order"). The Disgorgement
2 Order provides, "Mezzetti shall immediately return to the Debtor's estate all payments received from
3 the debtor since July 16, 1991." The Bankruptcy Appellate Panel and, subsequently, the Ninth
4 Circuit affirmed the Bankruptcy Court's ruling.

6 **C. Contempt Proceedings**

7 Mezzetti failed to comply with the Disgorgement Order, and GAP sought an order of
8 contempt from the Bankruptcy Court. The court issued an Order to Show Cause Why the Mezzetti
9 Law Firm Should Not be Held in Civil Contempt of Court. Following a hearing on the court's Order
10 to Show Cause, the Bankruptcy Court issued written findings of fact and conclusions of law in May
11 1994 holding Mezzetti in civil contempt for the firm's willful failure to comply with the court's
12 Disgorgement Order of July 1993. Mezzetti timely filed objections to the findings and conclusions
13 and sought *de novo* review of the Bankruptcy Court's findings and conclusions by the District Court.

15 **D. Settlement and Subsequent Dismissal of Chapter 11 Case**

16 While Mezzetti's request for *de novo* review was pending before the District Court, GAP
17 entered into a settlement agreement with Dover and its general partners in November 1993. The
18 settlement agreement includes a broad release purporting to release all claims against Dover and
19 related entities arising from the underlying loan transaction. Specifically, the Agreement Re:
20 Deficiency Judgment provides in pertinent part the following release language:

21 Lender . . . shall have the right, but not the obligation, to non-
22 judicially foreclose upon the Property if Lender has not previously
done so.

23 * * *

24 Lender hereby absolutely and irrevocably releases Borrower, Shulman
25 and his heirs, successors and assigns, and Borrower's officers,
26 directors, agents, servants, contractors, employees, parent and
27 subsidiary corporations and predecessors-in-interest (collectively the
"Released Borrower Parties") from any and all claims, rights,
demands, suits, causes of actions, losses, costs, obligations, liabilities

1 and expenses of every kind or nature, whether arising in contract, tort
2 or otherwise, known or unknown, suspected or unsuspected, fixed or
3 contingent, arising out of or relating to any statements,
4 representations, acts or omissions, intentional, willful, negligent or
5 innocent, by any of the Released Borrower Parties occurring prior to
the date hereof or in any way connected with, relating to or affecting,
6 directly or indirectly, the Loan, the Loan Documents, the indebtedness
7 of Borrower to Lender, the property securing the Loan, or the
8 relationship of Lender and Borrower or Lender and Shulman.

9 The settlement agreement defines the "Property" as that "... certain real property commonly
10 known as the Old Town Shopping Center." The court approved the settlement agreement by Order
11 entered on January 12, 1996. GAP conducted a non-judicial foreclosure sale of the property on
12 January 14, 1994 and credit bid less than the full amount of its debt.

13 Although the request for *de novo* review was pending at the time of the settlement, the parties
14 failed to provide in the agreement for the treatment of any funds that Mezzetti may subsequently
15 disgorge pursuant to court order. The agreement also makes no references to collateral other than
16 the real property.

17 After the foreclosure sale, the court dismissed the case on June 16, 1994 upon the debtor's
18 motion but specifically retained jurisdiction to hear matters relating to the Disgorgement Order and
19 the Contempt Order. The Order Dismissing Chapter 11 Case provides, "[T]his Court retains
20 jurisdiction to hear, decide and otherwise preside over all matters relating to that certain
21 Memorandum Opinion issued by this Court on or about June 29, 1993, or that certain Order Holding
22 the Mezzetti Law Firm in Civil Contempt issued by this court on or about May 2, 1994."

23 **E. District Court Order Upon Review**

24 Upon *de novo* review, the District Court, the Honorable Ronald M. Whyte presiding, adopted
25 substantially the findings of this court and increased the amount of the sanctions award to GAP to
26 compensate for additional attorneys' fees incurred in pursuing the matter through *de novo* review.
27 On reconsideration, Judge Whyte modified the order which held Mezzetti in civil contempt. The
District Court order as modified provides in pertinent part:

1 [T]he Firm shall forthwith return to the debtor's estate all payments
2 received after July 16, 1991 in an amount of \$55,606.39 plus interest
thereon at the rate of seven (7%) per annum from May 2, 1994.

3 3. The Firm shall in addition immediately pay to GAP
4 sanctions of attorneys' fees and costs in the amount of \$21,936.44
(i.e. \$8,474.93 plus \$10,916.51 plus \$2,545.00 (fees and costs
5 awarded in connection with reconsideration)).

6 * * *

7 4. If the Firm does not pay at least \$2,000 per month
8 beginning with the month of August 1995 continuing by the tenth of
each month thereafter until the amounts (reimbursement of debtor's
9 estate and sanctions of attorney's fees and costs) plus interest are paid
10 in full, the Firm must pay an additional \$100 per day to the debtor's
estate and GAP divided in accordance with the amounts then owing
to each of them as sanctions necessary to coerce compliance with this
order.

11 * * *

12 The court finds the Firm's argument that it cannot reimburse
13 the debtor's estate because it had been closed to be without merit.
The bankruptcy court retained jurisdiction over all matters pertaining
14 to its order holding the Firm in civil contempt. If there is a question
as to whom it should make its payment, the Firm can seek direction
15 from the bankruptcy court.

16 In the interim, Mezzetti and GAP have stipulated that Mezzetti would deposit the disputed
17 amounts into an interest-bearing account located at San Jose National Bank pending resolution by
18 this court.

19 DISCUSSION

20 By this motion, Mezzetti seeks clarification and direction from the bankruptcy court with
21 respect to two issues. Specifically, Mezzetti requests a determination from this court *whether*
22 payment of disgorged attorneys' fees in the amount of \$55,606.39 should be made notwithstanding
23 the dismissal of the chapter 11 case and to which entity to direct these payments. The motion also
24 seeks a determination of the appropriate order of payment as between the debtor's estate and GAP.
25

26 A. Payment of Disgorged Funds

27

1. Standing of GAP

At this, as well as at every other, juncture in the case, Mezzetti argues that GAP does not have standing to pursue the disgorged funds. The basis of Mezzetti's argument is that since GAP has settled its claims against the debtor and its principals, it no longer has a secured claim. Mezzetti further argues that because GAP has acquired by settlement the relief that it sought, mootness divests GAP of standing to pursue the disgorged funds. GAP's response appears to be based in part on the law of the case doctrine.¹ GAP argues that the foreclosure sale and dismissal of the case do not deprive GAP of standing and that, moreover, the court reserved jurisdiction to make orders relating to the disgorged funds. It contends that Mezzetti is simply causing further delay by attempting to relitigate the merits of the Disgorgement Order by contesting GAP's standing at this juncture.

Mezzetti's arguments as to GAP's standing appear to be directed to two separate issues. The first issue is whether GAP has a sufficient interest in the outcome of this proceeding to be heard. The second issue, which will be discussed infra, is whether GAP retains an interest in the disgorged funds notwithstanding the terms of the settlement agreement such that it is entitled to possession of the funds. With respect to the first issue whether GAP has standing in this matter under Article III of the United States Constitution, a party must have a sufficiently concrete interest in the outcome of the litigation to be conferred standing and thereby prevent mootness. Yniguez v. State of Arizona, 975 F.2d 646, 647 (9th Cir. 1992)(pursuit of nominal damages sufficient). See also Gollust v. Mendell, 501 U.S. 115, 111 S.Ct. 2173, 115 L.Ed2d 109 (1991)(corporate restructuring that dissipated value of shareholder's interest did not divest shareholder of standing). "[T]he emphasis in standing problems is on whether the party invoking federal court jurisdiction has 'a personal stake in the outcome of the controversy' and whether the dispute touches upon 'the legal relations of parties having adverse legal interests.'" United States Parole Commission v. Geraghty, 445 U.S. 388, 397,

¹ "The law of the case doctrine is a judicial invention designed to aid in the efficient operation of court affairs. Under the doctrine, a court is generally precluded from reconsidering an issue previously decided by the same court, or a higher court in the identical case. For the doctrine to apply, the issue in question must have been 'decided explicitly or by necessary implication in [the] previous disposition.'" Milgard Tempering, Inc. V. Selas Corp. of America, 902 F.2d 703, 715 (9th Cir. 1990).

1 100 S.Ct. 1202, 1209, 63 L.Ed.2d 479 (1980)(quoting Flast v. Cohen, 392 U.S. 83, 100, 88 S.Ct.
2 1942, 1953, 20 L.Ed. 947 (1968) (citations omitted)).

3 First, addressing GAP's argument that it is improper for Mezzetti to raise the standing issue
4 again, "the requisite personal interest that must exist at the commencement of the litigation (standing)
5 must continue throughout its existence (mootness)." United States Parole Commission v. Geraghty,
6 445 U.S. 388, 397, 100 S.Ct. 1202, 1209, 63 L.Ed.2d 479 (1980)(quoting Monaghan, Constitutional
7 Adjudication: The Who and When, 82 *Yale L.J.* 1363, 1384 (1973). Because GAP must maintain
8 a stake in the outcome of the litigation throughout its course, Mezzetti is not precluded from again
9 raising the issue of GAP's standing. GAP asserts that it is entitled to the disgorged attorneys' fees
10 based on its interest in cash collateral. The court's determination of the appropriate disposition of
11 the disgorged funds necessarily affects GAP's rights and gives GAP a stake and a concrete interest
12 in the outcome of this contested matter. GAP's interest in the attorneys' fees awarded as sanctions
13 by the District Court also gives GAP a sufficient interest in the outcome of this matter to confer
14 standing. The court's express reservation of jurisdiction in the dismissal order is indicative that the
15 parties contemplated that this issue remained unresolved and would require court determination in
16 the future.

17 18 **2. Estate Property Revests in Debtor**

19 Mezzetti reiterates an argument already found to be "without merit" and rejected by the
20 District Court. Specifically, the firm contends that it cannot comply with the District Court's order
21 to return the disgorged funds to the debtor's estate because the bankruptcy case has been dismissed,
22 and there no longer exists a bankruptcy estate. Dover Mobile Estates asserts that the disgorged funds
23 should be returned to the debtor because, under § 349(b)(3), estate assets revert in the debtor upon
24 dismissal of the case. GAP's position is that all payments by Mezzetti, including the disgorged
25 attorneys' fees, should be made to GAP because the disgorged funds constituted GAP's cash
26 collateral.

1 Mezzetti's motion raises the issue of the appropriate disposition of estate property upon the
2 dismissal of a chapter 11 case. Section 349(b)(3) provides that unless the court for cause provides
3 otherwise, the dismissal of a chapter 11 case reverts property of the estate in the entity in which the
4 property was vested immediately before the commencement of the case. 11 U.S.C. § 349(b)(3); In
5 re M.O.D., Inc., 170 B.R. 465, 466 (Bankr. M.D. Ala. 1994)(absent provision to contrary in the
6 order of dismissal, bankruptcy court could not grant fee application once property reverted in debtor
7 upon dismissal). This provision operates to revert property that is determined to be property of the
8 estate as of the date of dismissal in the entity that was vested with the property immediately prior to
9 the case. In re Tri-Glied, Ltd., 179 B.R. 1014, 1021 (Bankr. E.D.N.Y. 1995). As property that the
10 court ordered to be returned to the debtor in possession, the funds constitute property of the estate.
11 11 U.S.C. § 541(a). The dismissal order in this case was silent as to the disposition of property of
12 the estate. Property of the estate would have reverted in the debtor, Dover Mobile Estates, upon
13 dismissal of the case in June 1994. Thus, the disgorged funds reverted in Dover.

14 15 **3. GAP Is Not Entitled to Possession of Cash Collateral**

16 **a. Positions of the Parties**

17 Mezzetti argues that even if the funds were cash collateral subject to GAP's security interest,
18 that does not mandate that they be paid to GAP. Mezzetti further argues that GAP is not entitled to
19 turnover of the disgorged funds because the settlement agreement did not provide a reservation of
20 rights to pursue collateral other than the real property as a condition to the broad release granted by
21 GAP. Mezzetti has no liability to GAP for the disgorged funds, it argues, because, as an "agent" of
22 the debtor, the firm was released under the terms of the settlement agreement, which limited GAP's
23 remedy to non-judicial foreclosure of the real property. If GAP wants to obtain possession of those
24 funds, it must non-judicially foreclose on Dover's interest in the funds as additional security.

25 The debtor asserts that GAP is not entitled to the funds because it had merely a security
26 interest in, and not title to, the funds. It further contends that a determination of entitlement to the
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1 funds as between Dover and GAP is subject to state court jurisdiction. Finally, Dover asserts that
2 the settlement agreement fails to provide that any prospectively disgorged funds should be turned
3 over to GAP but specifically provides that all claims would be released, which necessarily includes
4 claims as to cash collateral.

5 GAP claims entitlement to the funds as its cash collateral. It further responds that the
6 settlement agreement did not release Mezzetti from his liability to the debtor under the disgorgement
7 order or liability to GAP because Mezzetti was an agent of Shulman, and not an agent of the debtor.
8 GAP argues that it may foreclose on additional collateral without violating the one-action rule or the
9 anti-deficiency laws although it has already foreclosed on the real property. The basis for this
10 argument is that it had bid less than the amount of the debt.

11 12 **b. Nature of Cash Collateral Precludes GAP's Possession**

13 GAP's argument that Mezzetti should pay the disgorged fund directly to GAP is misplaced
14 because it presupposes the secured creditor's right to possession of cash collateral. Cash collateral
15 constitutes cash or other cash equivalents in which the estate and an entity other than the estate have
16 an interest. 11 U.S.C. § 363(a). A debtor reorganizing under chapter 11 may use cash collateral but
17 only with the consent of the secured creditor or court authorization upon providing adequate
18 protection. 11 U.S.C. § 363(c)(2). These provisions protect the creditor's interest in the cash
19 collateral. 2 *Collier on Bankruptcy* ¶ 363.02 (15th ed. 1995). The creditor is not automatically
20 entitled to immediate possession of cash collateral in a chapter 11 case notwithstanding that it has a
21 perfected security interest in the collateral. *In re Carley Capital Group*, 128 B.R. 652, 656 (Bankr.
22 W.D. Wis. 1991); *In re EES Lambert Assoc.*, 62 B.R. 328, 338 (Bankr. N.D. Ill. 1986); *In re Little*
23 *Puffer Billy, Inc.*, 16 B.R. 174, 175 (Bankr. D. Ore. 1981). Whether a secured creditor has the
24 present right to possession of rents as cash collateral is a separate and distinct issue from whether the
25 creditor has a valid security interest. *See, e.g., In re Foxcroft Square Co.*, 178 B.R. 659, 664 (E.D.
26 Pa. 1995). *Cf., In re Goco Realty Fund I*, 151 B.R. 241, 248 (Bankr. N.D. Cal. 1993)(perfection of
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1 security interest under state law is distinct from enforcement, giving rise to right of possession of
2 collateral). Although GAP had a security interest in the funds at the time they were paid to Mezzetti,
3 that interest did not give rise to a right of possession of the funds.

4 5 **c. Whether Release in Settlement Agreement Encompasses Cash Collateral**

6 Under the guise of standing, the parties have also raised the scope of GAP's reservation of
7 rights under the settlement agreement. Mezzetti argues that GAP does not have standing to obtain
8 the funds because it released those rights under the settlement agreement. The issue appears to be
9 whether GAP is entitled to foreclose on rents under the terms of the settlement agreement.

10 **1. Jurisdiction to Construe Settlement Agreement**

11 The debtor submits that claims between GAP and Dover are subject to state court jurisdiction
12 because the bankruptcy court retained only limited jurisdiction when it dismissed the case. This
13 argument is misplaced. A court has jurisdiction to enforce its own orders under the doctrine of
14 ancillary jurisdiction. In re Poplar Run Five Ltd. Partnership, 192 B.R. 848, 859 (Bankr. E.D. Va.
15 1995)(citing Local Loan Co. V. Hunt, 292 U.S. 234, 239, 54 S.Ct. 695, 696-97, 78 L.Ed. 1230
16 (1934)). It also has ancillary jurisdiction to interpret or enforce a settlement agreement when the
17 order provides that jurisdiction will be retained over the agreement itself or when the terms of the
18 agreement are incorporated into the order. Id. The underlying rationale is that a breach of the
19 settlement agreement would constitute a violation of the court's order, which would invoke the
20 court's jurisdiction to protect its proceedings and to vindicate its authority. Id. (citing Kokkonen v.
21 Guardian Life Ins. Co., ___ U.S. ___, 114 S.Ct. 1673, 1677, 128 L.Ed.2d 391 (1994)). After
22 dismissal of a bankruptcy case, the bankruptcy court retains subject matter jurisdiction to interpret
23 orders entered prior to dismissal of the underlying case. In re Franklin, 802 F.2d 324, 326-27 (9th
24 Cir. 1986); In re Lawson, 156 B.R. 43, 46 (Bankr. 9th Cir. 1993). It also has subject matter
25 jurisdiction to dispose of ancillary matters. Lawson, 156 B.R. at 46. Actions are said to be ancillary
26 to the original suit when brought in aid of an execution or to effectuate a judgment entered in the
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1 prior suit. Id. The court has jurisdiction to determine the disposition of the disgorged fees. The
2 dismissal order contemplated this contingency, and the District Court directed that such questions
3 be resolved by the Bankruptcy Court. Pursuant to its ancillary jurisdiction, this court also has
4 jurisdiction to interpret the settlement agreement and to adjudicate its effect on the claims between
5 GAP and Dover to the disgorged funds.

6 **2. Construction Pursuant to California Contract Principles**

7 Court-approved settlements are given the same effect as judgments, Hoxworth v. Blinder, 74
8 F.3d 205, 208 (10th Cir. 1996), and, as such, they are interpreted pursuant to principles of contract
9 law. In re Columbia Gas System, Inc., 50n F.3d 233, 241 (3d Cir. 1995). See also In re the Hawaii
10 Corporation, 796 F.2d 1139, 1142 (9th Cir. 1986)(interpretation of settlement agreement governed
11 by state law of contracts); Gorman v. Holte, 164 Cal. App. 3d 984, 988, 211 Cal. Rptr. 34, 37
12 (1985)(settlement agreements are governed by the legal principles that are applicable to contracts
13 generally). Under California law, contracts are to be interpreted as to give effect to the mutual
14 intention of the parties as it existed at the time of contracting as far as it is ascertainable. Cal. Civ.
15 Code § 1636 (West 1985). A contract is to be construed according to the manifest intention of the
16 parties and cannot be varied by an undisclosed intention of one of the parties to the contract. Bell
17 v. Minor, 199 P.2d 718, 88 Cal. App. 2d 879 (1948); Canavan v. Osteopathic Physicians and
18 Surgeons, 166 P.2d 878, 73 Cal. App. 2d 511 (1946). The intention of the parties is to be ascertained
19 from the writing alone, if possible. Cal. Civ. Code § 1639. The words of the contract are to be
20 understood in their ordinary and popular sense, rather than according to their strict legal meaning.
21 Cal. Civ. Code § 1644.

22 Applying these principles of contract construction and based on the limited record currently
23 before the Court, the Court must conclude that GAP waived its interest in cash collateral in general
24 and the disgorged funds in particular. The release clause in the settlement agreement is very broad.
25 The disposition of the disgorged funds was an open issue at the time GAP entered into the settlement
26 agreement with Dover and its principles. Notwithstanding, the settlement agreement is silent as to
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1 collateral other than the real property. Moreover, at the time of the dismissal of the bankruptcy case,
2 the disposition of the funds to be disgorged by Mezzetti remained an open issue. The disposition of
3 the contempt motion upon *de novo* review by the District Court is not abrogated by the settlement
4 agreement, which is silent on the issue of the disgorged fees.

5
6 **B. Order of Payment**

7 The motion also seeks guidance as to the allocation of the \$2,000 payments mandated by the
8 District Court's Order. Mezzetti takes the position that the District Court Order contemplates that
9 prorated payments shall be made to the estate and to GAP simultaneously. The debtor asserts that
10 the payments should be prorated. GAP has taken the position that rather than prorating payments,
11 the \$2,000 monthly payments should be made to GAP until GAP is paid in full.

12 With respect to the question of the order of payment, the District Court Order provides that
13 Mezzetti should pay Dover "forthwith" and pay GAP "immediately." The Court interprets the terms
14 of that order to provide for simultaneous monthly payments to both Dover and GAP on a *pro rata*
15 basis.

16
17 **CONCLUSION**

18 Because property of the estate reverts in the debtor upon the dismissal of a case, Mezzetti is
19 ordered to direct payment of the disgorged funds to Dover Mobile Estates rather than to GAP.
20 Mezzetti shall also make payments to Dover and to GAP simultaneously on a *pro rata* basis.

21 Good cause appearing, it is SO ORDERED.

22
23 Dated:

UNITED STATES BANKRUPTCY JUDGE